

Various measures have been introduced in the course of the year to promote exports. Existing subsidy schemes for replanting and new planting of agricultural crops were generally revised upward. Grant of foreign exchange for business travel was considerably enhanced in 1978. The Greater Colombo Economic Commission was established to set up "Export Promotion Zones" with a view to attracting export oriented foreign investment. In the course of 1978, 52 approvals were granted for the establishment of such industries.

Another significant measure for promoting exports which was in the process of implementation (and introduced in 1979) was the establishment of an Export Credit Guarantee Corporation. This Corporation will assist exporters to obtain bank finance on a liberal basis and afford them a means of protection against the risks of non-payment or delayed payment by overseas buyers. Legislation was also in process of being enacted for the establishment of an Export Development Council of Ministers and an Export Development Board. The Board will be vested with the powers necessary for the development of exports.

BALANCE OF PAYMENTS¹

The performance of the balance of payments during 1978 was influenced largely by the economic reforms of 1977. The immediate impact of these measures on the balance of payments was perceptible in 1978, when the current account shifted back to a deficit of Rs. 782 million (SDR 64 million) from a surplus of Rs 1,266 million (SDR 116 million) in 1977. External assets, however, increased further in 1978 and the end year reserves were sufficient to finance four months' imports anticipated for 1979. The growth in external assets arose from the surplus in the capital account generated by a heavy inflow of long-term capital and by drawings from the International Monetary Fund (IMF).

The impact of the exchange and trade liberalization on balance of payments was felt critically in the field of imports. In SDR terms,² payments on imports rose by 30 per cent; the import bill increased from Rs. 6,290 million (SDR 622 million) in 1977 to Rs. 15,350 million (SDR 808 million) in 1978. The increase in imports reflected the release of the pent-up demand built up over the years of controls. The rise in imports stemmed mainly from a speeding up of imports of investment and intermediate goods, while imports of consumer goods rose at a lower pace. A more than twofold increase in the import of capital goods in 1978 was partly a reflection of the bottlenecks that existed in domestic industries for a number of years, and partly a result of increased industrial activity. While the foreign exchange resource constraints and stringent import controls in the past served to limit the utilisation of external resources to certain essential imports, they inhibited the inflow of investment goods

1. The trade data used in the balance of payments are actual receipts and payments during the year. They differ from the external trade data given earlier, which reflect the physical movement of exports and imports. The difference is due to the time lag between receipts and payments on one side and the physical movement of goods, on the other.
2. The frequent changes in the exchange rate of Sri Lanka and also the instability of exchange rates between major international currencies since 1977 introduced a serious problem of comparison of time series data on balance of payments. In the absence of a stable monetary unit, the relatively more stable Special Drawing Rights (SDR) has been used as a unit of account for the purpose of comparison.

required to sustain economic growth. With the elimination of import licensing for a wide range of items, importation of capital goods showed a vigorous improvement. The resulting increased availability of machinery, equipment and raw materials led to a better utilization of industrial capacity (70 per cent in 1978) which over the last four year period 1974-77 remained at a low level of about 57 per cent.

Although import payments increased substantially in 1978, it was nevertheless somewhat lower than the level originally projected for the year. This could be attributed to a number of reasons. First, even though the quantitative restrictions on imports were removed, the rise in import prices arising from the depreciation of the Sri Lanka Rupee tended to moderate the demand for imports. Second, the tightening of bank credit as an anti-inflationary measure set a liquidity constraint on importers. Third, some of the imported goods, durables in particular, did not move in the local market as fast as it was anticipated by importers, who were unable to assess the market easily. Fourth, after a long period of restrictions, it usually takes time for importers to organise themselves to cope with the new system and to re-establish contacts with foreign traders.

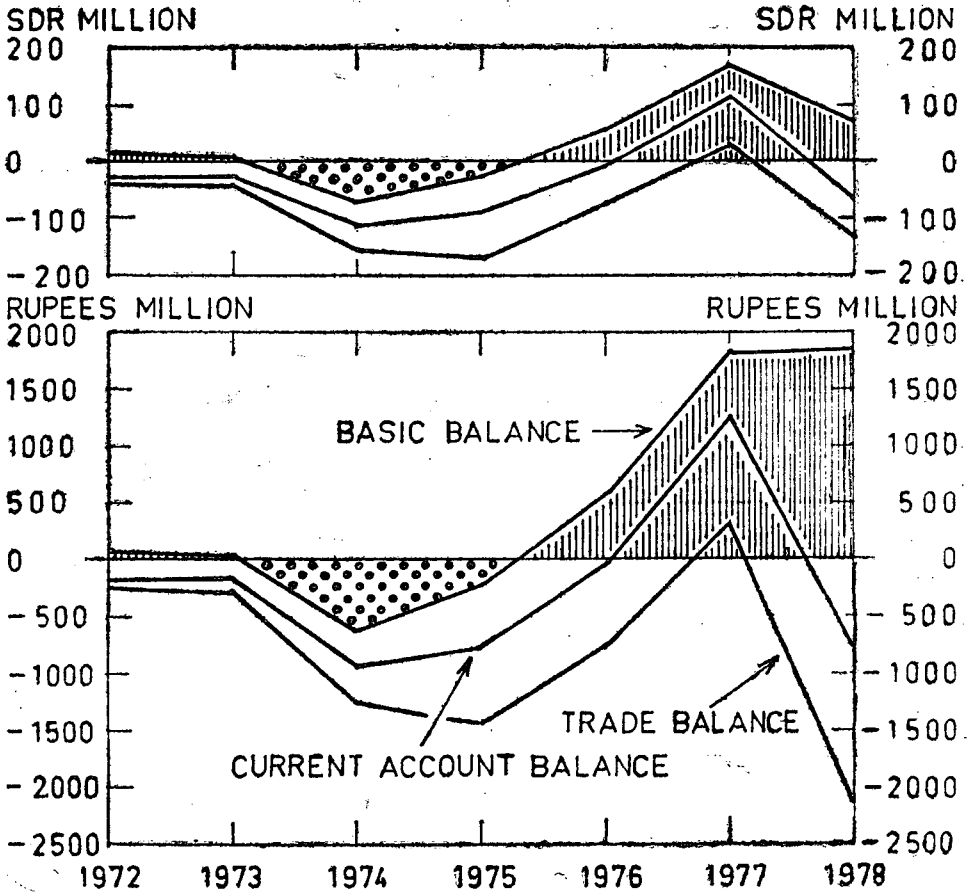
In contrast to a considerable increase in imports, the export earnings in 1978 recorded only a marginal increase from Rs. 6,640 million (SDS 651 million) in 1977 to Rs. 13,207 million (SDR 675 million) in 1978. Export earnings of Sri Lanka increased only by 4 per cent while aggregate export earnings of non-oil developing countries, as a group, grew at a much higher rate of 9 per cent in 1978. Since the output of major exports of Sri Lanka remained almost stagnant in recent years, the level of earnings from such commodity exports moved almost entirely in line with the fluctuations of international market prices.

The slower growth of exports and the much faster growth of imports, thus resulted in a shifting of the trade balance to a deficit of Rs. 2,143 million (SDR 133 million) in 1978 from a surplus of Rs. 350 million (SDR 28 million) in 1977.

The services account showed a lower surplus in 1978; the surplus declined from Rs. 304 million (SDR 29 million) in 1977 to Rs. 119 million (SDR 6 million). Following the relaxation of restrictions on foreign travel in November, 1977 the expenditure by Sri Lankans travelling abroad for business, export promotion and other purposes increased sharply from Rs. 33 million (SDR 3 million) in 1977 to Rs. 444 million (SDR 23 million) in 1978. Gross earnings from tourism have been estimated to have risen from Rs. 304 million (SDR 29 million) in 1977 to Rs. 750 million (SDR 38 million) this year. The surplus on port, transport and insurance declined. Largely as a result of these developments, the rising trend in the services account surplus experienced since 1973 was reversed in 1978. Inward remittances by Sri Lankans working abroad, particularly in the Middle East countries, have been estimated to have nearly doubled from Rs. 190 million (SDR 18 million) in 1977 to Rs. 610

BALANCE OF PAYMENTS

ANNUALLY



EXTERNAL ASSETS QUARTERLY

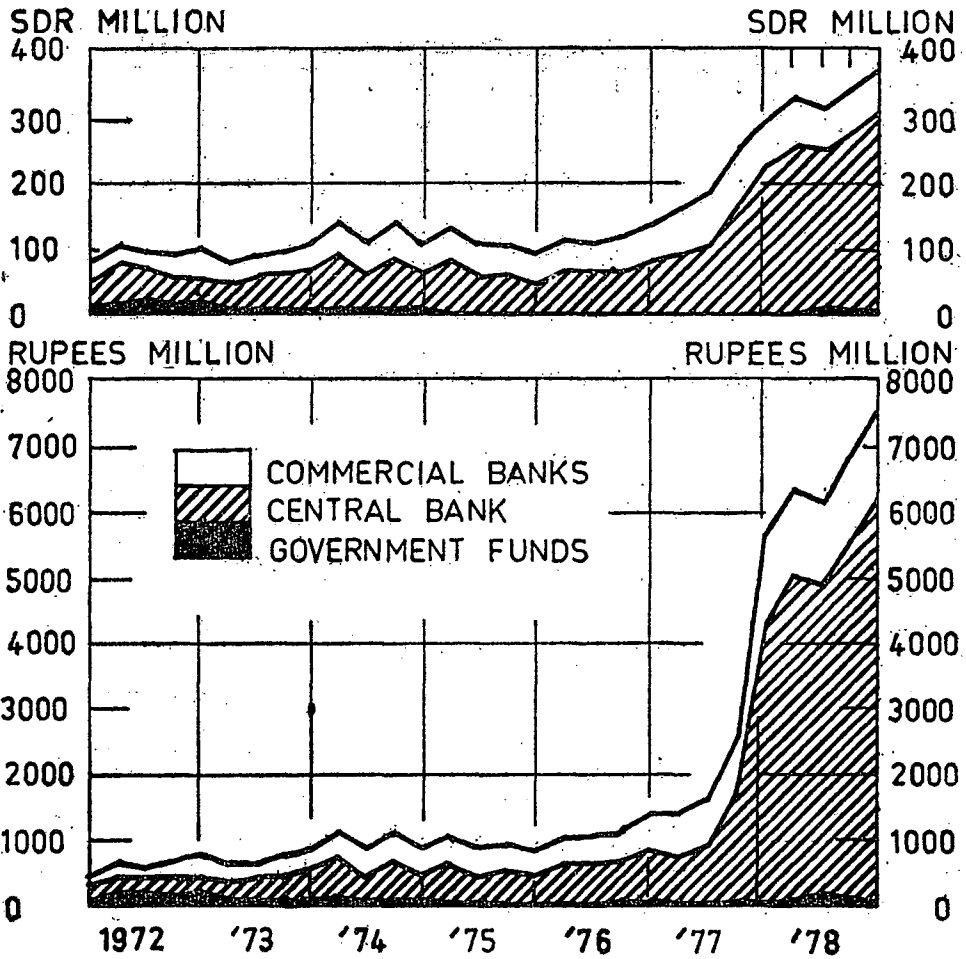


TABLE 1-12
Balance of Payments 1969-1978

Rs. Million (SDR Mn. in Brackets)

Year	Trade Balance	Net Services	Net Transfers	Balance on Current Account	Net Long-Term Capital	Basic Balance
1969	- 746 (-157)	- 90 (-19)	+ 39 (+8)	- 797 (-167)	+ 275 (+58)	- 522 (-110)
1970	- 315 (-52)	-104 (-17)	+ 69 (+12)	- 350 (-59)	+ 184 (+31)	- 166 (-28)
1971	- 287 (-47)	- 14 (-2)	+ 85 (+14)	- 216 (-35)	+ 404 (+66)	+ 188 (+31)
1972	- 255 (-38)	- 15 (-2)	+ 74 (+11)	- 196 (-29)	+ 292 (+44)	+ 96 (+14)
1973	- 299 (-39)	+ 53 (+7)	+ 85 (+11)	- 161 (-21)	+ 190 (+25)	+ 29 (+4)
1974	-1263 (-158)	+ 76 (+10)	+ 280 (+35)	- 907 (-113)	+ 298 (+37)	- 609 (-76)
1975	-1421 (-168)	+ 89 (+11)	+ 560 (+66)	- 772 (-91)	+ 559 (+66)	- 213 (-25)
1976	- 709 (-73)	+112 (+12)	+ 547 (+56)	- 50 (-5)	+ 610 (+63)	+ 560 (+58)
1977	+ 350 (+28)	+304 (+29)	+ 612 (+59)	+1266 (+116)	+ 563 (+54)	+1829 (+170)
1978*	-2143 (-133)	+119 (+6)	+1242 (+63)	- 782 (-64)	+2640 (+135)	+1858 (+71)

Source: Central Bank of Ceylon

* Provisional

million (SDR 31 million) in 1978 and this resulted in an increase in the surplus on total transfers from Rs. 612 million (SDR 59 million) to Rs. 1,242 million (SDR 63 million) in 1978.

The balance of payments in 1978 showed a surplus in its basic balance for the third successive year, as shown in Table 1-12. A surplus of Rs. 1,858 million (SDR 71 million) in the basic balance in contrast to a current account deficit of Rs. 782 million (SDR 64 million) reflected the heavy inflow of long-term capital into the country during the year. Net long-term capital inflows rose two-fold to an unprecedented level of Rs. 2,640 million (SDR 135 million) in 1978 and this was the largest increase ever recorded. An increase in the support by the International Monetary Fund together with increased assistance from other international organizations and foreign governments contributed to the high capital inflow. In view of the inadequacy of domestic financial resources to finance development programmes, the growth of external capital flow appears to be a significant development. Meanwhile, most of the new loans contracted in 1978 was based on relatively concessional terms.

With the rise in import payments following the liberalization, the external resource gap in 1978 increased more than two-fold to Rs. 3,798 million (SDR 219 million) (Table 1-13). This was in contrast to the previous year when the resource gap declined from a high level of Rs. 2,456 million (SDR 252 million) in 1976 to Rs. 860 million (SDR 87 million) in 1977. Whereas the improvement in 1977 was due to a sharp increase in export earnings stemming

largely from favourable prices for tea, the gap in 1978 widened owing to the slackened export performance coupled with a high import bill. The decline in the surplus on services was also partly responsible for the increase in the resource gap during the year.

The external resource gap in 1978 was financed almost entirely by long-term loans, as in 1977. The gross inflow of long-term loans increased considerably from Rs. 1,184 million (SDR 114 million) in 1977 to Rs. 3,680 million (SDR 188 million) in 1978, an increase of 65 per cent. Nearly one third of these loans was disbursed as project aid (Rs. 1,222 million or SDR 62 million) tied to various development projects. In addition, loans of Rs. 1,680 million (SDR 86 million) were disbursed from the commodity and food-aid pipe line. The I.M.F. provided Rs. 778 million (SDR 40 million) under its Trust Fund arrangement. The two final instalments of the I.M.F. Stand-by arrangement negotiated in the previous year provided Rs. 756 million (SDR 38 million). Receipts of grants amounted to Rs. 900 million (SDR 46 million) in 1978 and in foreign exchange terms, this was almost equivalent to the 1977 level. As a result of the marked increase in long-term financing availability in 1978, the need for recourse to non-concessionary short-term trade credits was further reduced, as in 1977.

Since long-term loan disbursements and grants were more than sufficient to fill the resource gap, the excess foreign exchange spilled over to external assets. In SDR terms, the gross external assets increased by 21 per cent to SDR 371 million (Rs. 7,477 million) at the end of 1978; and it was adequate to finance about four months' anticipated imports of 1979. The increase in external assets was reflected in a rise in the liquid balances held abroad by the Central Bank.

The debt service ratio i.e. capital repayments and interest (including IMF repurchases, bank borrowings) as a percentage of earnings from merchandise exports and services improved from 16 per cent in 1977 to 15 per cent in 1978. This was largely due to a decline in capital repayments on long-term loans and in suppliers' credits as well as a growth of earnings from exports and services.

Successful negotiations were made with the International Monetary Fund for an arrangement under the Extended Fund Facility, which is designed to provide medium-term balance of payments support. When approved in early 1979, it is likely that Sri Lanka could borrow upto SDR 260.3 million (Rs. 5,206 million) over the period 1979 to 1981. Normally, these drawings are repayable within four to eight years after each drawing - in 16 equal instalments - and are subject, at present, to a charge of 4.375 per cent per annum for balances outstanding for less than one year, the rate rising by 0.5 per cent a year for each succeeding year, up to a level of 6.875 per cent. The outstanding amount of external debt increased from Rs. 13,321 million (SDR 705 million) in 1977 to Rs. 16,446 million (SDR 813 million) in 1978. This resulted from a rise in long-term loans, consisting mainly of project and commodity aid. The outstanding level of long-term loans rose from Rs. 10,594

TABLE 1.13

Financing of the External Resource Gap 1976-1978

Category	Rupees Million			SDR Million ¹		
	1976	1977	1978	1976	1977	1978
1. Foreign earnings ..	5,459	7,753	15,759	561	758	805
1.1 Exports ..	4,707	6,640	13,207	484	651	675
1.2 Services ..	643	923	1,942	66	89	99
1.3 Private transfers ..	109	190	610	11	18	31
2. Foreign Payments ..	7,915	8,613	19,557	813	845	1,024
2.1 Imports ..	5,417	6,290	15,350	557	622	808
2.2 Services ..	584	687	2,091	60	66	107
2.3 Capital Repayments ..	1,914	1,636	2,116	196	157	109
3. External Resource Gap ..	-2,456	-860	-3,798	-252	-87	-219
4. Financing of the Resource Gap ..	+2,456	+860	+3,798	+252	+87	+219
4.1 Long-term Loans ² ..	943	1,184	3,680	96	114	188
4.2 Grants ..	492	490	900	51	47	46
4.3 Trade Credits ³ ..	1,266	360	114	130	35	5
4.4 Bank Borrowings ..	1	222	—	—	—	—
4.5 Bilateral Balances ..	—	—	1	—	—	—
4.6 I. M. F. Drawings ⁴ ..	273	935	756	28	55	38
4.7 Other ⁵ ..	59	119	208	7	11	10
4.8 External Assets ..	-568	-4,171	-1,904	-59	-169	-65
5. Valuation adjustment ⁶ ..	—	1,680	344	—	—	—
6. Errors and omissions ..	-10	+41	-301	-1	-6	-3

Source: Central Bank of Ceylon.

1. Time weighted average rates of Rs. 9.73 in 1976, Rs. 10.42 in 1977 and Rs. 19.58 in 1978 were used for conversions.
2. Project, commodity, food and other aid.
3. Suppliers' Credits and short-term trade credits.
4. Includes oil facility drawings.
5. Includes private capital.
6. Estimated increased value of external assets consequent on the changes in exchange rate.

million (SDR 561 million) in 1977 to Rs. 13,803 million (SDR 682 million) in 1978. The maturity structure of external debt lengthened further in 1978 as a result of less recourse to credits of short-term maturity.

The Sri Lanka Rupee depreciated against major currencies other than the U.S. Dollar in 1978. Since November, 1977 the Rupee depreciated by 8.3 per cent against the Pound Sterling, 18.8 per cent against the Japanese Yen, 16.9 per cent against the Deutsche Mark and 6.3 per cent against the SDR. On the contrary, the Rupee appreciated by 3.2 per cent against the U.S. Dollar.

EXCHANGE RATES

CUMULATIVE PERCENTAGE CHANGES
FROM NOVEMBER 16, 1977.

